Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

In the Matter of	)	
	)	
The Commission's Cable Horizontal and	)	MM Docket No. 92-264
Vertical Ownership Limits	)	

COMMENTS
OF
COMMON CAUSE
CENTER FOR CREATIVE VOICES IN MEDIA
CCTV CENTER FOR MEDIA & DEMOCRACY
CENTER FOR DIGITAL DEMOCRACY
CHICAGO MEDIA ACTION
MEDIA ALLIANCE
NATIONAL HISPANIC MEDIA COALITION
OFFICE OF COMMUNICATION OF THE UNITED CHURCH OF CHRIST, INC
PUBLIC INTEREST PICTURES
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Common Cause, Center for Creative Voices in Media, CCTC Center for Media and Democracy, Center for Digital Democracy, Chicago Media Action, Media Alliance, National Hispanic Media Coalition, Office of Communication of the United Church of Christ, Inc, Public Interest Pictures, and U.S. Public Interest Research Group ("Citizen Commenters") respectfully submit these comments asking that the Commission promptly adopt strong limits on cable horizontal ownership.

SUMMARY AND INTRODUCTION

In 1992, Congress passed a comprehensive statute designed to promote effective competition in the cable industry which, Congress concluded, had become dangerously concentrated and vertically integrated. In what the Supreme Court has termed "unusually detailed" legislative findings, supported by a lengthy legislative history, Congress identified numerous harms the flowed from the combination of monopoly at the point of sale and regional and national concentration. These included high prices, poor customer service, and market power over cable programmers. Congress also observed that market power over programmers increased cable operators' power to impede the entry of competing MVPDs and threatened the development of diverse programming.

As part of this comprehensive regime, Congress unambiguously ordered the Commission to set limits on national, and if necessary regional, concentration of cable operators. Recognizing the complex nature of cable market power and the dynamic nature of the communications market, Congress delegated this authority to the FCC. Although Congress expressed particular concern that the FCC ensure that no cable operator could "unfairly" impede the flow of programming to either viewers or competing MVPDs, Congress' primary target remained the market power of cable. Congress had no interest in ensuring carriage for any particular programming. Rather, Congress expressly directed the Commission to set a limit to "enhance effective competition" by limiting the market power of cable operators.

In adopting rules implementing the 1992 directive, the Commission erroneously concluded that Congress intended to give every programmer a "fair chance" to get on a cable system by providing an "open field." Compounding this error by assuming a perfectly competitive four-player market, the Commission contrived an ownership limit without regard to the structure of the MVPD industry or the nature of cable market power. The Commission assumed that guaranteeing independent programmers access to some number of national subscribers, and treating all viewers as fungible and equally desirable to programmers and the advertisers and investors that support them, it would have discharged its responsibilities under Section 613.

The D.C. Circuit found the Commission's analysis unpersuasive and remanded the matter to the Commission. The *TWE II* court faulted the Commission for its failure to provide any evidence linking the "open field approach" with the exercise of market power and for its failure to explain how the open field approach worked to "enhance effective competition" as required by the statute. In so doing, the *TWE II* court expressly recognized that other theories besides the "open field approach" could sustain the 30% limit, provided these new theories relied on evidence demonstrating a "real" rather than "conjectural" harm flowing from the exercise of cable market power above the limit designated by the Commission.

Citizen Commentors therefore applaud the Commission for seeking comment here on whether the Commission should abandon the open field approach and rely instead on a monopsony framework. As Congress understood, rules designed to create effective competition in the delivery of MVPD programming must rest on a thorough understanding of this complex industry and limit both national and regional concentration of its dominant players.

Almost four years ago, the Consumer Federation of America, *et al*. ("CFA") proposed a 25% national limit based on economic theory and existing industry structure. In issuing the present notice, the Commission concluded that CFA had failed to provide sufficient empirical evidence to demonstrate a "real" rather than "conjectural" harm. At the same time, it rejected the theories advanced by incumbents that effective competition already existed and that therefore the Commission should impose no limit at all.

It is of overwhelming importance to this proceeding that, between the time that the Commission issued its *Further Notice* in 2001 and the publication of the current *FNPRM*, the Commission has permitted Comcast to acquire AT&T Broadband, thus creating a cable MSO far above the limit proposed by CFA but at or above to the national limit the Commission deemed "safe."[1] Over the last three years, Comcast has engaged in all the behaviors Congress identified as flowing from a lack of effective competition – rate increases, poor customer service, and exercise of market power over programers. Comcast's conduct provides abundant empirical validation for adopting CFA's proposed 25% cap.

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[1]As discussed below, Citizen Commenters do not concede the validity of the self-serving data generated by proprietary data sources. While Comcast undoubtedly can present data showing that it is below 30% of the nation's cable homes, Citizen Commenters believe that it is just as likely that use of different data sources would show it to be above 30%. As Part V explains, this is why the FCC must collect its own data.

Part I explains why the Commission should focus on monopsony power as Congress intended. Furthermore, the legislative history and statutory language of the 1992 Cable Act and Section 613(f) in particular demonstrate Congress' understanding of the complexities of cable market power and the need to set horizontal limits to enhance the likelihood that effective competitors would emerge. This history also makes clear what Congress meant by "effective" competition, and why the Commission's "open field approach" utterly fails to address the Congressional intent or the plain language of the statute.

Part II reviews the CFA's economic arguments from four years ago and supplements these with an analysis of Comcast's behavior now that Comcast has passed the 25% limit recommended by CFA. Comcast's ability to engage in all the behaviors Congress identified as flowing from market power demonstrates the validity of CFA's approach.

Part III introduces new evidence regarding the how regional concentration reinforces both local and national market power and the need to establish regional, as well as national, limits. Furthermore, increased regional concentration combined with national concentration undermines the ability of local franchising authorities to enhance effective competition and regulate abuses of market power – frustrating the increased role of local franchises created by Congress in the 1992 Act. This in turn allows Comcast, with its national and regional concentration, to resist LFA demands for PEG access and PEG support. This interference with PEG programming "unfairly" impedes the flow of video programming from PEG programmers to viewers, and undermines the government purpose "of the highest order" in promoting an informed citizenry and ensuring access to diverse local programming.

Part IV addresses the legal framework imposed by *TWE II* and answers the questions posed by the *TWE II* Court. First, Commentors address whether DBS provides effective competition to cable. Applying the framework established by the D.C. Circuit's *en banc* decision in *United States v. Microsoft* (decided after the *TWE II* decision), it becomes apparent why DBS does not mitigate the market power of cable operators despite significant national subscriber growth (an analysis aided by a proper focus on industry structure and monopsony power, rather than on the "open field" approach). Next, an analysis of the relevant legislative history and statutory language demonstrates what Congress meant by "unfair" when it instructed the Commission to ensure that no cable operator or group of cable operators could "unfairly" impede the flow of programming to viewers or rival MVPDs. Finally, a review of Comcast's actions and the opinions of previously successful cable programmers that Comcast exercises market power over programmers resolves the issue of whether a 25% rule designed to limit monopsony power addresses a "real" rather than a "speculative" harm.

Finally, ***Part V*** urges the Commission to improve its information collection and data analysis in order to genuinely understand the industry and provide effective oversight. The Government Accountability Office (GAO) has ***twice*** chastised the FCC for poor data collection and cautioned Congress that the FCC data on competition in the MVPD market are so unreliable as to be worse than useless. As the GAO warned, this lack of reliable information compromises "the ability of the FCC to monitor and provide oversight of the cable industry." GAO 2003 Competition at 19.

In particular, the FCC has an obligation to determine whether the conditions of Section 612(g), the so called "70/70 rule," are met. In the most recent FCC report on competition in the MVPD industry, the FCC actively avoided making a finding that 70% of homes passed by cable systems with 36 or more activated channels subscribed to those systems by discarding contradictory industry data in exchange for unexplained "sampling" of data GAO had explicitly criticized as unreliable. The

Report also relied on ***projected*** loses of subscribers by cable incumbents, rather than on verifiable reports of subscriber gains.

This behavior goes beyond poor data collection and innocent error. To disregard contrary industry data in favor of unreliable and unverified projections amounts to a campaign of active ignorance designed to avoid the truth and its consequences. As the GAO observed, this behavior has consequences beyond the FCC's refusal to regulate cable market power. With the importance of broadband, the implications of convergence, and concentration in the media, cable plays a critical role in our national economy and our information infrastructure. Cable operators' capacity to manipulate the programming market and eviscerate PEG access strike at the heart of the news and diversity of views necessary to sustain our democracy.

The FCC must collect real and reliable data, not play games to avoid the need to regulate. The future of our democracy and economy depends on it. As citizens we deserve no less.

I. THE COMMISSION SHOULD ABANDON THE "OPEN FIELD" APPROACH IN FAVOR OF AN EXAMINATION OF MONOPSONY POWER.

The Commission's "open field" approach erroneously assumes the competitive market that requires some minimum number of competitive players to give any single independent programmer a "chance" of getting on a network. This approach misconceives Congress' intent in creating the ownership limit. To the extent Congress intended to minimize the impact of market power on any individual cable operator, it acted to strengthen leased access provisions and prohibit demands for equity as a price of carriage. 1992 Cable Act §§ 9, 12; Senate Report at 23, 29-32.

The horizontal ownership limit, however, goes more broadly to the general market power of cable networks by virtue of their national and regional concentration. Senate Report at 32-34. The statute makes clear the intent to "enhance effective competition" so that the general market power of incumbent cable operators as a matter of sheer size is limited. Creation of an "open field" based on some minimum number of available subscribers in a hypothetically competitive market is, indeed, conjectural. And, in light of the fact that this hypothetically competitive market does not exist in the real world, the "open field approach" will have no impact on the exercise of market power over programmers.

Unless the Commission addresses the underlying ***causes*** of programming discrimination by addressing industry structure, it does not matter how many "open" subscribers a programmer could reach. As explained below, cable operators derive their power from (a) the unique nature of the service sold – a service not dependent on the availability of any one new independent program; (b) the monopoly at the point of sale; (c) the inelasticity of demand for the service; and (c) sufficient size and resources for any one player to set policy for the industry and overwhelm competitors. National size also allows a cable operator to overwhelm the pro-competitive effects of local regulation, further diminishing the competitive forces. Limits on national size create effective competition, and therefore "ensure" that no single programmer or group of programmers "unfairly" restricts the flow of commercial or PEG programming by reducing absolute size. Regional limits further diminish the ability of cable operators to leverage local monopolies and control regional programming to the detriment of regional competitors such as overbuilders, and even to the detriment of national competitors such as DBS.

Accordingly, the Commission should focus its efforts on measuring the monopsony power exercised by the largest cable incumbents and the cable industry generally. Measures such as HHI, Tobin's q, Lerner Index, and Pogue are all broadly accepted tools among economists to measure market power, and the Commission should avail itself of these.

Above all, the Commission must make use of ***multiple*** tools in order to reflect the dynamics of the communications markets. Section 613(f)(2)(E). As described in Part II, the cable industry and associated markets represent a complex system where many variables both create the ability to exercise market power and reenforce each other. This complexity increases as new technologies and industry patterns simultaneously create new opportunities for competitors and mechanisms for reenforcing market power.[2] Finally, the manner in which local market power at point of sale, regional concentration, and national size effect market power presents an enormously complex problem for the Commission to resolve.

For this reason, although the Commission must set a firm numeric limit as a matter of law, Section 613(f)(1), it must not rely on any single tool for measuring monopsony power. Rather the Commission should use a variety of tools – including those discussed above – to triangulate the source of monopsony power and set limits that promote effective competition.

As the Senate Report indicated, the dynamic nature of communications markets will require the FCC to revisit this limit from time to time. Senate Report at 80. A more restrictive limit may prove necessary if effective competition does not emerge. Conversely, if effective competition emerges, a less restrictive limit may at some point be appropriate. Given current market conditions, however, in which Comcast already exercises market power to the detriment of subscribers, programmers, and local governments, the Commission should act expeditiously to impose a restrictive limit at once, subject to reexamination as effective competition emerges.

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[2]For example, any deployment of broadband with open access and non-discrimination requirements could create new programming distributors, whereas deployment of broadband without these regulations reinforces the market power of the cable network operators.

A. The Structure and Legislative History of the 1991 Act Make Clear That Congress Intended to Address Cable Market Power Generally, Not Create an Open Field for Any Given Programmer.

In 1992, alarmed by concentration levels well below those of today, Congress acted to limit the cable MSO from leveraging their power in the MVPD market. Congress sought to increase competition in the MVPD industry and remedy the ills of concentration in the interim. 1992 Cable Act Section 2(b) (policy to promote competition and regulate where competition has not emerged).[3]

Critically, Congress intended the remedies in the act to work ***together*** to produce effective competition that would remedy the harms Congress identified as flowing from local and national cable market concentration. While Congress expressed concern that national concentration allowed cable operators to favor affiliated programming, demand equity as a price of carriage, and block diverse unaffiliated programming from subscribers, Congress did not limit its concerns to these problems alone.

To the contrary, the legislative history demonstrates Congress' understanding that the lack of competition at the local franchise level (not merely at the national level) created numerous problems for subscribers. S. Rep. 102-92, "Cable Television Protection Act of 1991," at 3-9 ("Senate Report"); H. Rep. 102-628, "Cable Television Consumer Protection and Competition Act of 1992," at 30-34 ("House Report"). The legislative history and the Congressional findings show that Congress understood high prices, poor customer service, and poor quality of service flowed from a lack of competition and a lack of choice for subscribers.

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[3]Critics of the practice of relying on legislative history often complain that Congressional reports and floor transcripts do not necessarily reflect the intent of Congress. In the case of the 1992 Cable Act, Congressional intent is explicitly stated in the statute's elaborate and detailed findings of fact.

At the same time, the structure of the 1992 Act shows that Congress did not intend any one provision to work in isolation. For example, in addition to requiring Congress to consider how ownership limits would prevent cable operators from interfering with the flow of unaffiliated programming, Congress also required the Commission to take specific measures to prevent the most obvious abuses of requiring exclusivity or equity as a price of carriage. 1992 Cable Act Section 12 (47 USC 536). In numerous places, Congress prefaced new provisions with the precatory language that it intended the provision or regulation to "promote effective competition." *See* Section 9 (adding "to promote competition in the delivery of diverse sources of video programming" to purpose of 47 USC 532(a)); Section 19. Congress also eliminated the ability of local franchise authorities to grant exclusive franchises, Section 7 (modifying 47 USC §541(a)(1), and gave LFAs the right to reject a transfer that would diminish competition for cable services. Section 11 (modifying 47 USC 533 (d)).

The "effective competition" criteria of Section 613(f) prohibits the Commission from focusing exclusively on the impacts on the programming market. In measuring both the effectiveness of existing competition, and the necessary limit to impose to "enhance effective competition," the Commission must consider the full panoply of ills Congress saw flowing from the lack of effective competition – higher prices, poor customer service, and unfair programming practices.

Notwithstanding the breadth of its mandate, the FCC has viewed its task as extremely narrow. The Commission's exclusive focus on effects in the programming market and subsequent adoption of the "open field approach" apparently arose from the prominence given to programming concerns in the list of factors the Commission must consider when setting the horizontal limit. Section 613(f)(2)(A)-(B), (G). This ignores not merely the statute's plain language that the Commission address "***other public interest factors***" (emphasis added), but also ignores the remaining specific criteria the Commission must address.

B. Harms That Demonstrate the Lack of Competition Include Higher Prices and Poor Customer Service As Well As Market Power Over Programmers.

A reading of the legislative history, as well as the findings and policies of Congress, show the harms Congress saw flowing from the lack of effective competition in the MVPD market.

First and foremost, the legislative drafters found that the lack of effective competition in the MVPD market produced higher prices for consumers. Senate Report at 3-9; "Cable Television Consumer Protection and Competition Act," House Report at 30-34. This follows both common sense and well established judicial precedent. As the D.C. Circuit has observed, the capacity to raise prices profitably above the competitive level demonstrates the lack of effective competition. *United States v. Microsoft*, 253 F.3d 34, 51-52 (D.C. Cir. 2001) (*en banc*) ("*Microsoft*").

Second, the lack of effective competition allows cable operators to offer poor customer service and poor quality of service. Senate Report at 20-22; House Report at 34-37.

The Senate drafting committee addressed the horizontal limit as but one part of a set of provisions targeting the ability of cable operators to impede competition through control of the programming market. Senate Report at 23. At the same time, however, the drafters intended the provision to further the overall goals of effective competition. *Id.* at 34 (purpose of provision "to address the issue of national concentration ***and*** enhance effective competition).

Similarly, the House Report links cable market power and the ability to raise rates with the absence of a horizontal ownership limit. House Report at 42. The drafting committee understood the complex relationships in the factors that permitted cable operators to maintain monopsony power at the local, regional and national level, including (but not limited to) the exercise of control over the programming market. *Id.* at 42-44.

This broader purpose of enhancing effective competition as a whole, not merely the impacts upon the programing market, are reflected in the prefetory language ultimately used. As the D.C. Circuit observed, Congress intended the horizontal limit "to enhance effective competition." *Time Warner Entertainment Co., L.P. v. FCC*, 240 F.3d 1126, 1135-36 (D.C. Cir. 2001). The statute does not purport to limit focus to only on the programming market. Rather, as with the rest of the statute, Congress intended the FCC to establish limits that would "best serve the public interest." Senate Report at 80.

C. The Harms Congress Identified Have Intensified With the Continued Increase in National and Regional Concentration.

In the years since Congress passed the 1992 Cable Act, the Commission has allowed both national and regional competition to increase at an alarming rate. As the Government Accountability Office (GAO) has found, the Commission's continued declarations in official reports that "effective competition" exists in the MVPD market derive from poor data collection and data processing and do not reflect the actual state of competition. GAO, " Data Gathering Weakness in FCC's Survey of Information on Factors Underlying Cable Rate Changes," (2003) ("FCC Data Gathering Weakness"). *See also* GAO, "Issues Related to Competition and Subscriber Rates in the Cable Television Industry," (2003) at 12-19 (" GAO 2003 Competition") (FCC cable pricing report replete with inaccuracies and fails to independently validate industry generated data, undermining reliability of FCC reports and compromising oversight of industry).

Over the last five years, cable prices have increased at a rate that significantly outpaces inflation. The cable industry has argued that these rate increases reflect both increases in the cost of programming and the increase in capital expenditures to provide more and higher quality services. The publically available economic data, however, belie this explanation.

As the attached chart from the Buske Group (Attachment A) shows, that cable operators have enjoyed an increase in both the number of subscribers and profit per basic subscriber over the last several years. If cable prices reflect increases in cost, why has profitability per customer increased? If DBS or other competing MVPD systems provide effective competition, why have cable providers continued to enjoy an increases in subscribers while raising prices? The answers are that cable price increases reflect market power.

In addition to the rise in prices, subscribers have seen a rapid decrease in the quality of service they enjoy. Notably, the vast majority of these complaints come from territories controlled by Comcast – the largest MVPD. *See* Reply Comments of NATOA, *et al.* In Support of Petitions to Deny, Docket No. 05-192 (filed August 5, 2005). Rather than enjoy cost savings from efficiencies of national and regional concentration, as the Commission predicted when it permitted Comcast to acquire AT&T Broadband, subscribers have "enjoyed" poor response time to complaints, increasing numbers of "no shows" and missed appointments by cable installers and service appointments, and regular rate hikes. *See, e.g.* Sean R. Sedam, "Pols, Customers: Comcast Bears Blame As Complaints Rise," Montgomery County Gazette (July 27, 2005); Camille T. Taiara, "The People v. Television," San Francisco Bay Guardian (April 2, 2005).

As discussed at greater length below, the promised growth in "unaffiliated programming" has likewise proved illusory. To the extent there has been any increase in unaffiliated programming is attributable in large part to the separation of Liberty Media and the content it controls from its previous affiliation with AT&T Broadband (formerly TCI), and the increase in the number of channels offered by incumbents that gained carriage either by affiliation with cable operators or broadcasters. *See* Michael E. Clements and Amy Abramowitz, "Ownership Affiliation and the Programming Decisions of Cable Operators," U.S. Government Accountability Office (2004). Many of these unaffiliated networks are simply modestly differentiated versions of the primary offerings.

Finally, cable operators continue to deny desired programming to their own subscribers and deny affiliated programming to rival MVPDs, including DBS. The experience of Mid-Atlantic Sports Network (MASN) provides clear evidence that the practice of demanding equity interests as a condition of carriage remains more than 10 years after passage of the 1992 Cable Act. The experiences of The America Channel, KVMD Licensee Co., LLC, and DirecTV and Echostar's experiences with iN Demand show that little has changed since 1992 when Congress ordered the Commission to set a limit or from 2002 when the Commission received further evidence of program discrimination from Sherjan, the Catholic Television Network, and others.

Indeed, the problem has grown worse with the increased size of Comcast – which surpasses the 25% limit urged by CFA and sits at or above the 30% limit the Commission deemed "safe" in 1999. Industry leaders such as John Malone freely admit that Brian Roberts, as head of Comcast, can make or break any network by granting or refusing carriage. *See, e.g.,* Mark Robichaux, "From Darth Vader to Yoda," Broadcasting and Cable, April 4, 2005.

The Commission cannot blithely dismiss these statements as anecdotal or the sour grapes of disappointed rivals. These statements come from the leaders of the programming industry. If these industry leaders – billionaires with access to capital markets and with unquestioned familiarity and experience with the cable industry, with histories of resisting any government regulation of cable – openly state that Comcast has the power to unilaterally decide the success or failure of a new programming network, the Commission must take these assertions seriously.

If, as the cable operators argue, effective competition exists, how can the problems Congress identified as flowing from the ***lack*** of effective competition persist? It would appear that, even at the existing levels of concentration, effective competition does not exist.

II. COMMENTS SUBMITTED FOUR YEARS AGO BY CFA CONTINUE TO PROVE THEIR VALIDITY.

Nearly four years ago, CFA submitted detailed economic comments and legal comments explaining that, to prevent the harms Congress identified as flowing from a lack of competition in the MVPD market, the Commission could justify, and should set a limit of 25% of total MVPD subscribers for cable multi-system operators (MSOs).[4] The events of the last four years, particularly since the Commission approved the acquisition of AT&T Broadband by Comcast, have demonstrated the accuracy of CFA's theory and analysis.

While the Commission and cable incumbents continue to laud the growth of DBS subscribers as evidence of increasing competition, the market realities tell a very different tale. The persistence of unrestrained price increases, declines in customer service and quality of service, and a proliferation of affiliated networks at the expense of genuine unaffiliated networks makes clear that DBS has not provided effective national or regional competition. This fits CFA's prediction that, absent a 25% limit on horizontal ownership, cable operators would have sufficient national market power to resist competition from DBS.

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[4]As a concession to political realities, CFA suggested that the Commission set the limit at 30%, to avoid any divestitures. In addition, CFA argued the Commission should reverse its 1999 determinations in the *1999 Ownership Order* to use total MVPD subscribers rather than cable homes passed, and reverse the determination in the *1999 Attribution Order* to allow insulation of limited partnerships. Citizen Commenters here do not abandon these arguments, and incorporate them by reference.

A. Four Years Ago, CFA Explained the Nature of Cable Market Power and the Need for a 25% Limit.

To assist the Commission's analysis, Citizen Commenters briefly reiterate the chief arguments submitted by CFA four years ago. To simplify matters, Citizen Commenters have omitted the citations present in the original filings.

1. Market structure and the nature of cable products facilitates market concentration absent regulation.

Analysis of the market structure of the cable industry demonstrates that the cable industry has market power which must be checked by a horizontal limit. Economic public policy is essentially concerned with market performance, a multidimensional variable which includes both efficiency and fairness, and which is measured by pricing, quality, and profits. Market performance is affected and circumscribed by market structure, and analysis of market structure must proceed from the number and size of the firms in an industry, their cost characteristics and barriers to entry, and the basic conditions of supply and demand – including elasticities and the constraints of available technologies. Underlying this analysis is determination of the extent to which market structures support or hinder competition. In conditions of competition, firms compete on price and services, driving efficient allocation of resources, lowest cost production, and innovation in the delivery and production of new services.

While the cable industry has displayed modest innovation in the deployment of digital channels and broadband services, it has retained the power to raise prices and control the type and nature of innovation on its systems. This indicates an absence of effective competition with regard to price and innovation.[5]

It has long been recognized that information production, communications networks, and video programming exhibit unique economic characteristics. In particular, they display a similarity to non-excludable, non-rivalrous public goods with positive externalities and high first-copy costs and susceptibility to network effects. In addition, because of the role of information products and information networks in national infrastructure, holders of these networks able to control production of information have increased incentive and ability to exclude rivals.

Modern information products also exhibit significant nonsubstitutability and strong preferences with little ability for individual substitution between media products or institutions. A service capable of delivering a mix of 24 hour news programming and entertainment programming, such as MVPD services, is simply not comparable to a service that provides a single stream of mixed programming, such as a broadcast network, and even less similar to one-time entertainment programming, such as a video rental store. Consumers wanting a mix of programming choices will not regard non-MVPDs as substitutable for MVPDs, and the unique value and characteristics of these goods will render demand relatively inelastic.

As a result, the relevant markets will not naturally consist of numerous companies engaged in atomistic competition. Left without supervision, the dominant players will evolve rather tight, differentiated oligopolies or monopolistically competitive entities. These firms derive their market

[5]As discussed below, the manner in which MSOs have expanded their programming offerings also suggests the exercise of market power, rather than a response to effective competition. Recent developments with regard to the programming market, such as the ability to deny competing MVPDs regional sports programing and iN Demand programming, and the ability to deny viewers desired programming, such as local sports programming offered by unaffiliated regional sports networks, demonstrate the absence of competition in the programming market as well.

power based on the inability of consumers to cut back demand and competitors' inability to increase supply, and thus increase profitability by raising price and/or reducing quality. Public policy must, therefore, concentrate on preventing abuses of market power and on encouraging competition at all layers of the communications platform through manifold regulatory mechanisms.

2. Monopsony power flows from horizontal expansion, vertical integration, and tacit collusion facilitated by the nature of the industry.

Paralleling the monopolistic effects of market power are similar monopsonic effects. In both cases, it is precisely the absence of the disciplinary market forces characteristic of effective competition which affords such market-dominant actors the ability to exercise market power.

In addition to the effects of horizontal market power, vertical market power provides a significant motivator for horizontal limits, given the existence of conduit and content discrimination in the cable industry. Conduit discrimination consists of a vertically-integrated company refusing to distribute its affiliated content over competing transmission media. Content discrimination consists of an integrated provider blocking or otherwise degrading the quality of unaffiliated content. Both forms of discrimination have been repeatedly identified in the policies and practices of the major cable actors. A limit designed to create effective competition must take this incentive and ability to discriminate into account.

In addition, the rule must consider the traditional problems produced by concentrated market power - barriers to entry, foreclosure of input markets to competitors, exclusive and preferential deals for use of facilities and products, cross-subsidization, price squeezes and discrimination, and the imposition of higher costs or lower quality of service to gain advantage. The rule must also account for the well documented tendency in concentrated industries for collusion and coordination, particularly in the form of mutual forbearance and reciprocity. This collusion need not take the form of a stated *quid pro quo* and, indeed, rarely does. Because the market consists of a relatively few participants with the same set of incentives, the same potential rivals, and the same costs, participants engage in tacit collusion with little need to communicate directly.

The absolute failure of any significant incumbent cable MSO to overbuild the territory of another, despite strong economic incentive to do so, and despite potential gains in efficiency from increased size (the justifications offered for industry clustering and consolidation), lends credence to the theory of implicit collusion. The theory of implicit collusion is further reenforced by the actions of the industry in 1997 to prevent the emergence of a rival satellite network capable of challenging cable dominance, and by the willingness of cable operators to reenforce regional dominance through "swaps" even where the systems exchanged do not have equivalent value.[6]

Market power at the point-of-sale reduces competition which allows the dominant actors to favor their own programming or to hinder unaffiliated programming in reaching the market, while vertical integration creates additional incentives to withhold programming from downstream competitors or to squeeze those competitors out of the market by increasing their costs.

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[6]Although the value of increased regional concentration cannot be explained merely by regional economies of scale and gains in network efficiency and reduction in local costs – such as consolidating several local call centers into a single regional one – existing data suggest an additional incentive beyond tacit collusion to achieve these values while avoiding overbuilding the territory of a neighboring incumbent. The local market power of a cable operator appears to increase with regional dominance, enhancing the ability to exact monopsony rents from subscribers and deny necessary inputs to regional rivals. The continued increase in per subscriber profit enjoyed by the industry as regional consolidation increases – despite increases in programming costs and capital expenditures for system upgrades – lends support to this theory, as does the recent proposed transaction between Comcast, Time Warner, and Adelphia. *See* Petition to Deny of Free Press, *et al.*, Docket No. 05-192 (filed July 21, 2005) and attached Declaration of Dr. Gregory Rose.

3. Monopoly at the point of sale and the ability to engage in joint ventures further enhances the market power of incumbents.

The 30% limit adopted in 2000 allows the industry to become more concentrated than it should be, given the economic characteristics and historical behavior of the industry. The market share of cable operators in their core product and geographic markets is still approximately 85%. The cable companies have never competed for new markets by building new systems, despite the availability of this option for decades. Cable companies go to considerable lengths to avoid competing head-to-head.

In the programming and programming services market, cable operators maintain a number of joint ventures. These reduce rivalry between cable operators and facilitate the exclusion of potential competitors. Further, as the *Antitrust Guidelines for Collaborations Among Competitors* observes, joint ventures between competitors require particular scrutiny, as they may easily become vehicles for facilitating collusion (both implicit and explicit) and for exclusion of potential rivals. Federal Trade Commission and U.S. Department of Justice, "AntiTrust Guidelines for Collaborations Among Competitors," (2000) at 3 (some agreements among competitors *per se* anticompetitive, others subject to rule of reason to determine whether procompetitive impacts outweigh potential anticompetitive effects).

Local markets are a virtual monopoly. Out of more than 3000 cable systems, head-to-head competition occurs in fewer than 200, although another 150 have certified entry, amounting to only roughly one percent of franchise areas experiencing head-to-head competition. The availability of DBS competitors has not produced any significant behavior in pricing or customer service at the point of sale monopoly, in sharp contrast to those few localities that contain two or more terrestrial competitors.

This monopoly at point-of-sale is reinforced by a strong tendency toward "geographic regionalization," or clustering. This local cable market power is exacerbated by concentration on the national level, since it discourages potential competing entrants by the huge economies of scale which the dominant national actors possess.

4. As a consequence of these factors, cable operators continue to exercise market power in the programming market.

Market power in the programming production market produces significant monopoly rents for cable operators which vastly exceed the cash flow earned by non-integrated programmers. These rents, which are capitalized in the sales prices of cable systems, are 100 times the amount being paid to non-affiliated programmers. Only the tight oligopoly of programmers of marquee brands on cable networks – limited to networks affiliated (or formerly affiliated) with cable system operators or broadcaster networks – command sufficient power to force MSOs to share the monopoly rents collected from subscribers and other programers.

There is a link between market structure, collusion, and market power. When both distribution and programming are controlled by the same companies, there is no incentive to bargain to drive down the price of programming. Vertical and horizontal integration enables dominant firms to exercise price leadership. These dominant firms control enough of the market to enable them to frustrate any competitors' entry which might threaten their dominance. Overall profits for such actors can be increased by increasing programming prices, since they obtain rewards from sales to both integrated and non-integrated distributors. Inelastic demand and lack of competition at point of sale permits independent cable operators to pass price increases for programming through to consumers because competitors who are not affiliated with the dominant local/regional actors have little ability to compete.

The lack of competition in programming is further exacerbated by the fact that unaffiliated MVPDs can do nothing about it. With the possible exception of a few programmers in professional sports that derive their primary revenue from other sources (such as MASN) or that hold a monopoly over valuable programming that prevents cable operators from punishing them by exclusion (such as the National Football League), independent programmers would far prefer carriage on the largest cable MSOs to their rivals because these cable MSOs can guarantee large viewers in desirable markets. In addition to this "carrot," cable MSOs can punish independent programmers by exclusion. The consistent failure of the Commission to take action in program access complaints in an effective manner reenforces this behavior on the part of cable operators and independent programmers.[7]

Independent programmers do not compete on price because, first, they risk access to the markets controlled by the integrated programmers and, second, they can live comfortably by following the leader. The effects on consumers in such a situation are considerable, as evidence by the never-ending cycle of price increases.

The problems which vertical and horizontal integration present have long been prevalent in the cable industry and are directly the consequence of an historic and continuing pattern of market power abuse by the dominant actors. The dominant, integrated firms get the best deals and favored status over other actors. Exclusive arrangements prevent competing technologies from gaining access to programming as well as stifling competition within the cable industry.

Price discrimination against competitors and placing competing programming at a disadvanta-

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[7]In this regard, it is telling that not a single programmer on a cable system chose to respond to the Commission's detailed survey on negotiation practices within the cable industry.

geous position on the dial are common practices. Exclusive deals with independents which freeze-out overbuilders, refusal to deal for programming, tying arrangements, and denial of access to facilities have been the subject of antitrust litigation even among the dominant actors. The industry has reached the point where so clear a pattern has emerged that the commission can no longer dismiss instances as mere anecdotes.

One of the most obvious ways in which vertical and horizontal integration adversely affect consumers is price. Unregulated rates have increased rapidly with prices still increasing roughly 2.5 times as much as general inflation. Indeed, for the entire period of unregulated cable prices, prices have increased at between two and three times the rate of inflation.

This contrasts markedly with other communications industries affected by passage of the 1996 Telecommunications Act. Cable prices have increased rapidly in an environment where most other communications-related prices have fallen. Exacerbating this pricing pattern has been the way the industry has restructured its revenue stream to maximize the leverage provided by market power.

Bundling, price discrimination, and other anti-consumer behaviors drive consumers to buy bigger and bigger packages of programs at higher prices. While basic packages were being expanded and bundled to force consumers to pay higher prices, rates for pay services were flat.

Cable operators have often pointed to their expanded program offerings as proof that they respond to competition from DBS. But this ignores the fact that consumers must accept the bundle of programming whether they want it or not. Cable operators, however, have two incentives for expanding programming offerings that explain this behavior more rationally than response to competition by DBS. First, it allows operators to increase subscription prices, increasing revenue per subscriber. To the extent the expanded programming offerings represent an increase in vertical integration by expanding the number of offerings from the cable MSO, the expansion allows the MSO to increase its own programming revenues and marginally increase its market power to the extent the new programming proves genuinely popular. Finally, the increase in offerings increases local advertising revenue. Rather than betokening competition, therefore, the ability to force consumers to buy larger and more expensive programming packages provides another example of market power.

In short, the current system transforms consumer surplus into producer surplus. In the presence of any significant competition such practices would have been impossible to implement, because consumer behavior would have compelled introduction of a la carte packaging.

5. Use of relevant economic measures, such as Tobin q, support the conclusion that the cable industry does not face effective competition, requiring a stringent limit on national ownership.

The most frequently used measure of extraction of value from consumers is the sale price of systems. When systems sell for significantly more than the cost of build them, the assumption is that entry barriers are preventing competition from driving down prices because where systems could be built for significantly less than they are being sold, there must surely be something preventing entrants from entering the industry. In this circumstance, cable operators who possess market power can amass large monopoly premiums because of the difficulty of entry. This phenomenon is measured by Tobin's q. Looking at the data from 1983 to 2000, the value of Tobin's q for the cable industry has dramatically risen from roughly 1.6 to nearly 4, despite declining in the regulated period of the 1990s. Since 1996 the effect of deregulation has been to increase the monopoly premium enormously and with it the value of Tobin's q.

B. The Recent Data on Price Increases, Poor Customer Service, and Abuses of the Programming Market Are Consistent With CFA's Theory of Market Power Rather Than With An Environment of Effective Competition.

In the *2nd FNPRM*, the Commission tentatively concluded that CFA had failed to provide sufficient evidence to support its theoretical arguments on cable market power. The Commission dismissed as anecdotal the incidents of submitted by unaffiliated programmers, such as Sherjan and the Catholic Television Network, and the evidence of discrimination against overbuilders and DBS competitors. At the same time, it found serious flaws in the theories advanced by cable MSOs purporting to demonstrate that cable MSOs could not possess market power as a consequence of national size or that effective competition already existed in the MVPD market.

In the two years, since the Commission approved Comcast's acquisition of AT&T Broadband, Comcast has enjoyed a level of national concentration above the 25% limit urged by CFA at or above the 30% limit previously endorsed by the Commission. This provides an opportunity to test the theories advanced by the parties. If CFA correctly predicted a need for a 25% limit, one would expect to see a continuation of the problems that arise from a lack of effective competition, with Comcast most able to raise prices, drop customer service, and exercise the greatest control over the programming market (although the theory of tacit collusion would also support these trends among other cable operators to some degree). If the Commission had correctly set the level at 30%, one would expect modest moderation of prices and a general diminishing of anticomeptitive impacts over time as effective competition asserted itself. If effective competition already existed, as the cable MSOs insist, one would expect to see prices declining, customer service improving, and a decline in the ability to control the programming market.

All observable empirical facts show a market devoid of effective competition, thus supporting

CFA's predictions. Cable prices have continued to rise well above the rate of inflation. Indeed, in Comcast territory in particular, rate increases have come with remarkable regularity, despite the purported competition from DBS. Similarly, Comcast territories have seen a dramatic increase in complaints to LFAs over poor customer service and a steep rise in customer dissatisfaction. Cameron Barr, "Comcast Repair Complaints Surge," Washington Post (July 17, 2005); "People v. Television" *supra* (reporting that "a 2004 American Customer Satisfaction Index survey found that Comcast ... has the worst customer satisfaction rating of any company or government agency, including the Internal Revenue Service"). Commentors also note that a single email alert has generated more than 20,000 individual comments expressing dissatisfaction with the current state of the cable industry.

Alarmingly, in addition to the rise of behaviors explicitly identified by the authors of the 1992 Act as arising from a lack of effective competition, Comcast has demonstrated sufficient national and regional power to undermine the regulatory of local franchising authorities. *See* Reply Comments of NATOA, *et al.*, Docket No. 05-192 (filed August 5, 2005). As NATOA has explained, Comcast demonstrated capacity to ignore commitments in its franchise agreements and withhold franchise fees derives from Comcast's national and regional concentration and the lack of a potential competitor for the franchise.

Finally, with regard to the programming market, Comcast has demonstrated that it can "unfairly impede...because of size...the flow of video programming from the video programmer to the consumer" and restrict the flow of affiliated programming to competing MVPDS. Section 613(f)(2)(A)-(B). Although discussed in greater detail below, the comparison of the experiences of MASN and YES Network provides an illustrative example of the one cable company that at present exceeds CFA's suggested 25% horizontal limit to exercise power over programming where a smaller MSO cannot.

Mid-Atlantic Sports Network (MASN) controls the television rights to the Washington Nationals baseball team and, after 2006, will control the television rights to the Baltimore Orioles.[8] Comcast actively sought the television rights to the Nationals and has challenged the right of MASN to carry Orioles games. When these efforts failed, Comcast sought an equity interest and a promise of exclusivity as a condition of carriage on Comcast's network – the dominant cable network in the Orioles-Nationals viewing area. When MASN refused these conditions, Comcast refused to carry MASN. (For its part, Comcast maintains that it has refused to carry MASN until resolution of its pending law suit for breach of contract.

Under the theories advanced by cable MSOs, Comcast's refusal to carry popular programming, and the availability of this programming on two competing MVPDs (terrestrial overbuilder RCN and DBS provider DirecTV) should result in massive subscriber loss. Under CFA's theory, the inelasticity of demand, dominant regional market share, and superior resources vis a vis programmers (and, as discussed below, high switching costs to subscribers) protect Comcast from significant subscriber loss despite denying subscribers popular programming.[9]

The lack of a mass exodus from Comcast or accompanying dramatic rise in RCN and DirecTV subscriptions conforms with the theory advanced by CFA. Despite heavily advertising the availability

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[8]The facts provided here come from MASN's program access complaint and its Petition to Deny filed in the Comcast/Time Warner/Adelphia transaction under consideration in Docket 05-192.

[9]No one seriously contends that Washington Nationals games are not popular programming that regional subscribers desire to see. Members of Washington's city council have expressed considerable concern on behalf of their voters that thy cannot see programming after the city spent considerable public money to bring the Nationals to Washington. *See* Eric Fisher, "Comcast-Orioles Battle Intensifies," The Washington Ties (June 19, 2005).

of Nationals baseball on their own systems, subscribers have preferred to complain to Comcast and their elected officials rather than switch to competing MVPDs. This result is simply incompatible with the theory that incumbent cable operators dare not leverage their market power against programmers for fear of a customer rebellion.

This contrasts with the experience of YES Network, which held the rights to Yankees baseball programming, when Cablevision refused to provide carriage. Although Cablevision initially refused to carry YES, it ultimately yielded to customer pressure and agreed to carry YES as part of its basic tier. *See, e.g.*, James Rutenberg, "Cablevision Says No to Pro-Stadium Ads and Jets Say That Isn't Fair," New York Times (March 8, 2005).

What distinguished Cablevision from Comcast, so that Cablevision could not foreclose programming in the same manner? Two factors appear relevant. First, Cablevision enjoys nowhere near the national concentration that Comcast enjoys. Second, Cablevision did not have the same level of regional concentration. Cablevision controls only about a third of the New York City DMA, whereas Comcast controls approximately two thirds of the Washington D.C. DMA. Again, this supports the theories advanced by Commentors that national concentration above 25%, coupled with significant regional concentration, permit a single programmer to "unfairly impede . . . the flow of programming" in violation of the statute and to the detriment of creating effective competition.

III. BECAUSE REGIONAL CONCENTRATION ENHANCES NATIONAL, REGIONAL AND LOCAL MARKET POWER, THE COMMISSION MUST IMPOSE REGIONAL LIMITS PURSUANT TO SECTION 613(f)(2)(C).

The Commission's previous determination not to impose regional limits came from its erroneously focus only one aspect of the lack of effective competition – market power over national commercial programmers. More fundamentally, because the FCC focused on creating an "open field" based on available national subscribers rather than on reducing the ability of cable operators to exercise monopsony power, the FCC failed to investigate the link between regional concentration and monopsony power. As the statute both commands the FCC to understand this relationship, Section 613(f)(2)(C), and cannot enhance effective competition or ensure that cable incumbents will not exercise market power without such understanding, the FCC must address this issue here.

A. Legislative History.

Although the legislative history makes some reference to regional concentration, Congress did not speak to it in the same detail as it did to either monopoly at the point of sale or national concentration. This is understandable since, at the time of the 1992 Act, cable companies had not yet engaged in a strategy of focused geographic concentration. While Congress therefore had before it considerable evidence of the power of local monopoly at the point of sale and evidence of the power of national concentration, Senate Report 8-34, it had little evidence of the effects of regional concentration. As a result, Congress focused its primary statutory remedies at directly creating competition at the local level (*e.g.*, strengthening the power of local franchises, reform of leased access, prohibition on exclusive franchises) and mitigating effects of national market power (program access, prohibition on demands for equity as condition of carriage).

But Congress did not intend to ignore the potential for regional concentration to create market power. To the contrary, it prudently directed the expert agency to "take particular account of ***the market structure***, ***ownership patterns***, and other relationships in the cable industry, including the nature and market power of the local franchise." Section 613(f)(2)(C) (emphasis added). In so doing, Congress instructed the Commission also to consider the "dynamic nature of the communications marketplace," 613(f)(2)(E), and adjust its regulations to reflect emerging economic realities. Senate

Report at 34, 80.[10]

B. Changes in National Programming Markets.

Even a year later, when the Commission first addressed the issue, the conclusion that regional concentration did not have impacts in the national programming market (and a disregard for the regional programming market) remained understandable. Beyond the narrow scope of local sports programming, almost no regional networks existed. Nor did regional concentration yet rise to a level that would suggest the impacts of regional concentration on the national programming market. Nor did evidence exist as to how regional concentration would undermine the ability of LFAs to mandate local PEG programming or weaken the ability of LFAs to enhance effective competition through use of the local franchise. Finally, but no less significantly, as of 1992, the cable industry had not demonstrated that it is was technologically or economically feasible to distribute programming via terrestrial fiber rather than by satellite.

Since the Commission's last *Horizontal Ownership Order* in 1999, however, the growth of regional concentration has produced considerable evidence of the impact of regional concentration on local, regional and national market power. Refusal to reconsider the need for regional limits, therefore, would not merely be arbitrary and irrational but would frustrate the Congressional direction to set limits that promote effective competition, take ownership patterns into account, and reflect

[10]Congress demonstrated its concern that problems might arise if cable companies focused on regional concentration as an anticompetitive strategy in its directive to the Commission to study local sports programming. This study explicitly included an analysis of "local, ***regional***, and national sports programming." 1992 Act Section 26 (emphasis added). By including analysis of regional sports networks, Congress presciently foresaw the very discrimination Comcast has engaged in with regard to such sports networks as New England Sports Network (NESN) and demands for exclusivity from MASN. Congress' decision to order a study rather than take immediate action demonstrated legislative prudence – both in refraining from acting ahead of data and in foreseeing the rise of regional monopolies.

changes in the communications markets.

As discussed in comments filed by others and in the proposed Comcast/Time Warner/ Adelphia transfer,[11] concentration at the regional level directly impacts market power over the programming market and over the MVPD markets both regionally and nationally. Regional concentration undermines the ability of local and federal regulators to detect anticompetitive conduct and address it effectively. *See In re Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee,* 14 FCCRcd 14712, 14741-42 (1999). It also undermines the ability of LFAs to directly regulate the anticompetitive conduct of franchisees.

More perniciously, regional concentration permits the distribution of ever more programming *via* the "terrestrial loophole," circumventing the protections intended by Congress. As the drafters of the 1992 Act intended program access and the horizontal ownership to work together to address the problem of market power over programmers (in addition to enhancing effective competition in the MVPD market generally), the Commission must use its authority to set regional limits to address issues it has consistently found it has no authority to address in the program access regime.

Citizen Commenters propose that the Commission place an interim freeze on any applications that would result in a significant increase on regional concentration, pending development of a regional concentration limit. As numerous regions already suffer dangers levels of regional concentration, the Commission may also wish to consider whether to use its powers to force divestitures, as it has done in wireless mergers to preserve effective competition. *See, e.g., Sprint/Nextel,* FCC 05-148 (released August 8, 2005) (requiring divestiture of wireline business); *Cingular/ AT&T Wireless,* 19 FCCRcd

[11] *See, e.g.,* Petition to Deny of Free Press, *et al.*, Petition to Deny of DirecTV, Reply Comments of NATOA, *et al.*, Reply Comments of CFA & CU.

21522 (2004) (requiring divestitures in specific markets).

C. The Importance of PEG Access and the Local Franchise.

In considering the nature of the harm caused by national and regional concentration, the Commission must consider the impact of national and regional concentration on public, educational and government (PEG) programming. Since growing to its current level of national and regional concentration, Comcast has acted to cut PEG access and unfairly interfere with the flow of programming between PEG programmers and viewers.

Since the 1984 Cable Act, Congress has recognized the importance of PEG programming in promoting diverse sources of information and in informing citizens about their local governments – a government purpose of the highest order. Senate Report at 52. Congress intended PEG access to work in conjunction with the horizontal and vertical ownership limits to further the twin interests of promoting diversity and promoting effective competition in the programming market. *Id.* PEG programming provides opportunities for local and regional voices from all segments of the community to speak in English or even their own language. This programming serves not merely the targeted audience, but enriches the entire community as a whole.

From the point of view of the MSO, however, PEG access represents a cost of franchising. In addition to providing channel capacity, numerous communities exercise the statutory right to require cable franchisees to make studios and equipment available for PEG programming. In addition to the desire to use channel space to promote affiliated networks, cable operators do not derive even the usual revenues they would derive from showing unaffiliated programming and selling local advertising. While PEG programming provides valuable social return and serves the public interest, the cable operator has every economic incentive to reduce or eliminate PEG programing.

PEG programming rests entirely on the power of the local franchising authority to request PEG channels as a condition of the franchise. As cable companies grow more nationally and regionally concentrated, the balance of power shifts from the franchising authority to the incumbent cable operator. A large enough cable operator can engage in an endless "war of attrition" with local franchising authorities, filing lawsuits and generally refusing to cooperate. The LFA, however, has few tools to compel compliance beyond cancelling or refusing to renew the franchise.

Unfortunately, national and regional concentration has also undermined the threat of cancellation or refusal to renew. For one thing, any given franchise will account for a much smaller percentage of revenue in a larger operator than in a smaller operator. An operator with a national reach in excess of 25%, particularly one with significant regional concentration so that loss of a single franchise does not significantly diminish coverage of the designated market area (DMA) as a whole, can afford to lose access to a franchise area – especially where such action establishes a reputation for the MSO as a "tough negotiator" that will not be "pushed around" by an LFA.

In addition, few LFAs will actually cancel a franchise and go through the process of finding a new franchisee. LFAs do not wish to leave their residents without cable service. But increased national and regional concentration have eliminated possible replacements for the existing franchisee. As a result, large incumbents (notably Comcast) continue to operate for years after expiration of the franchise.

The same logic that applies to renewals applies to transfers. Following Comcast's acquisition of AT&T Broadband, a few LFAs refused to allow transfer of the franchise. Comcast continues to operate these systems, however, because AT&T Broadband no longer exists and LFAs do not wish to deprive their residents of cable programing.

Since exceeding the 25% level that has been advocated by CFA, Comcast has engaged in a continuing campaign to eliminate PEG access. For example, Comcast unilaterally terminated support for PEG programming in the city of Brookline, MA over the objections of the city. Kennan Knudson, "Town May Pull The Plug on Comcast," The Boston Globe (July 23, 2005). In Walnut Creek, CA, Comcast agreed when it acquired the local franchise from AT&T Broadband that it would abide by the terms of a community assessment to set the terms of the pending franchise renewal. After acquiring the franchise, Comcast sued in federal court to escape its franchise commitment. *Comcast v. City of Walnut Creek, California*, 371 F. Supp.2d 1147 (2005).

Congress explicitly enhanced the power of LFAs to deny or condition franchise transfers in the 1992 Act as a means of promoting effective competition. *See, e.g.*, Senate Report at 47-49. Specifically, Congress permitted LFAs to refuse to transfer franchises if the transfer would result in a reduction in competition for cable services, 1992 Cable Section 11(b), and reaffirmed the importance of demanding PEG access and institutional networks ("iNets") as a franchise condition. 1992 Cable Act Section 7(a) (modifying 47 USC §541).

The Commission must set a limit low enough to protect the ability of LFAs to protect PEG access and protect their franchising interests generally. Although it is impossible to set such a limit with precision, the dramatic increase in Comcast's "unilateral renegotiation" of franchise agreements to the detriment of PEG access and LFAs generally since acquiring AT&T Broadband indicates that 25% is a "tipping point." Accordingly, to protect the flow of PEG programming to the public, and to protect the ability of LFAs to enhance effective competition, the Commission should set the limit at 25%.

IV. PROPER UNDERSTANDING OF THE *TIME WARNER* FRAMEWORK ELIMINATES THE COMMISSION'S CONTINUED CONFUSION AND REQUIRES EXPEDITIOUS ADOPTION OF A 25% LIMIT.

A great deal of confusion has resulted from the D.C. Circuit's decision remanding the cable ownership limits. Unsurprisingly, cable incumbents have further obscured the issues by treating obvious *dicta* of the Court as findings of fact, ignoring the deference shown to the agency's predictive judgement, and the clear statement that the agency could support a 30% limit by adopting a different rational and on an appropriate record.

The Commission's reiterated questions in the 2nd *FNPRM* demonstrate that the Commission also continues to labor under confusion as to the proper legal framework. A brief review of what *Time Warner II* addressed and what it did not address, as well as answers to the specific questions asked by the Commission, seems appropriate here.

As an initial matter, the *TWE II* Court did ***not*** presume to pass judgment on facts and agency opinions not before it, and explicitly observed that "there are theories of anticompetitive behavior other than collusion that may be relevant to horizontal limit and on which the FCC may rely on remand." 240 F.3d at 1133. Evidence of such theories "does not require a complete factual record" and the FCC should rely on its predictive judgement borne of its expertise and familiarity with the industry generally. *Id.* The Commission, however, had "put forth no evidence at all" in support of its open field approach.

Similarly, the court did ***not*** find that DBS acted as an effective competitor to cable. Such a finding would have substituted the court's judgment for that of the expert agency. Rather, the court admonished the FCC that any subsequent rule must explain the strength or weakness of DBS as a competitor, as the availability of a competitor may mitigate the effects of market share. *Id.* at 1133-34.

Finally, the court determined that any limit must have the goal of "enhanc[ing] effective competition." Other effects, such as promotion of diverse programming, could not sustain the national ownership limit unless the ownership limit selected by the Commission did not ***also*** "enhance effective competition." *Id.* at 1135-36.

The court did not specify what Congress meant by this phrase, nor could it have done so on the basis of the record before it. Because the FCC relied upon a narrow interpretation of Congress' intent, and justified its 30% limit only in terms of the "open field" approach, the *TWE II* Court could opine on nothing else. To the extent its statements go beyond the rationale presented by the FCC, those statements can have no precedential value.

Given the continued confusion and assertions by incumbents, what *TWE II* did not say is as important as what *TWE II* did say. The court made no findings with regard to the competitive status of DBS, properly leaving such a determination to the agency. Nor did the court require the FCC to set a limit higher than 30%, or require any specific type of evidence.

A. Competition From DBS or Other Providers Has Not Proven "Effective" as Required By Congress.

The command that the FCC adequately explain the competitive impact of DBS remains by far the most misunderstood statement of the *TWE II* court. The court observed that the availability of a competitor may mitigate against a showing of market power, despite a high market share from a competitor. Incumbents have subsequently repeated at every opportunity that the *TWE II* court found that DBS ***is*** an effective competitor to cable.

As discussed in Part I, however, market realities do not show that any "effective" competitors to cable have emerged. That statute commands that the FCC set a limit on ownership that will enhance

effective competition. "Effective" competition would, as envisioned by Congress, mitigated the ability of cable MSOs to raise rates, deliver poor customer service, and exercise monopsony power over the programming market to the detriment of subscribers and cable competitors. Yet these problems persist, despite the much touted subscriber gains of DBS.

To the extent DBS has gained subscribers, therefore, it has not become an "effective" competitor to cable by any observable measure.

DBS has no impact on rates, and ceased to have impact on Comcast customer service after Comcast grew above 25%. Study after study has demonstrated that the national availability of DBS has not had any impact on the ability of cable MSOs to raise rates. More recently, as Comcast has climbed to its current level of national and regional concentration, the presence of DBS as a potential competitor has done nothing to prevent a ***decline*** in Comcast's customer service. To the contrary, customer complaints in recent months have surged. *See* Cameron Barr, "Comcast Repair Complaints Surge," Washington Post (July 17, 2005). Furthermore, the experience with MASN suggests that DBS does not provide effective competition with regard to the programming market.

DBS subscriber growth does not come from cable incumbents, and appears to have tapered off. If DBS genuinely competed with cable for customers, one would expect an overall decline in cable subscribers as they migrate to DBS. But no such decline has happened. Cable has continued to enjoy growth, albeit in the last few years at the more modest pace of a mature industry. If DBS competes with cable, why hasn't the cable industry shown a loss of subscribers, rather than a net gain?

Indeed, DBS gains appear to have leveled off, now that the MVPD market has reached maturity. DirecTV has reported disappointing growth, despite numerous promotions. Mark Seavy, "DirecTV Posts 2nd-Quarter Profit, Tightens Credit Terms," Communications Daily (August 5, 2005) (subscriber gains "well below even the most bearish Wall St. expectations"). These lackluster growth numbers follow changes designed to prevent individuals with poor credit histories from subscribing and from disconnecting customers who do not pay their bills. *Id.* This suggests that to the extent that DBS has in fact attracted customers from cable, this "churn" comes from customers rejected by the cable industry for refusal to pay for service rather than from subscribers migrating as a result of dissatisfaction.

It also raises questions as to the genuine nature of the previous subscriber gains. In 2002, DirecTV admitted that it had boosted its subscriber rate by as much as 10% by including potential subscribers who had subsequently cancelled their installation requests and subscribers terminated for overdue payments. *See Written Ex Parte of CFA* (Docket 92-264), October 18, 2002 and sources cited therein. DBS subscriber growth may therefore be seriously overestimated.

Citizen Commenters note that in the 11th Annual Competition Report, the Commission did find some loss of cable subscribers. Several factors, however, make the Commission's conclusions in this regard suspect. In 2003, the GAO chided the FCC for failing to validate industry provided subscriber figures independently. GAO 2003 Competition at 19. The GAO also issued a separate report exclusively devoted to an extensive description in the flaws of the FCC's methods of monitoring the cable industry, and warned Congress that it could not consider ***any*** numbers provided by the FCC as reliable. GAO Weakness in FCC Data Collection. GAO 2003 Competition at 19. Yet in compiling the data for the *11th Annual Report*, the FCC explicitly rejected independent industry data demonstrating a gain in cable subscribers. Instead, relied on a combination of uncertified and unverified ***projections*** of losses from the major incumbents and "sampling" of the data the GAO had twice found unreliable. *11th Annual Report*, 20 FCCRcd 2755, 2766-68 (2005).[12]

Finally, the investigations by the GAO in 2003 and 2005 found that DBS growth came primarily from rural areas or communities with no cable provider or where a cable provider offered very limited service. *See* GAO, "Direct Broadcast Satellite Subscription Has Grown Rapidly, But Varies Across Different Types of Markets" (2005) ("GAO 2005"); GAO 2003 Competition. Numbers of new subscribers in urban areas – particularly in areas where cable operators have upgraded their systems to provide digital service and broadband – have the lowest growth rate and remain low in absolute terms. GAO 2005. In light of these facts, and the problems that face DBS as a competitor explained below, the Commission must question whether DBS will continue its rate of subscriber growth.

1. Solving the DBS mystery – Why DBS does not provide effective competition despite steady increases in national subscriber rates?

In *United States v. Microsoft*, the D.C. Circuit, sitting *en banc*, set forth the proper criteria for determining whether a competitor offered effective competition in a concentrated market. It bears particular emphasis that, to the extent any part of *TWE II* is inconsistent with *Microsoft*, the subsequent *en banc* decision by the Circuit overrules the previous panel determination in *TWE II*. Accordingly, to evaluate DBS' effectiveness as a competitor in accordance with the mandate of *TWE II*, it must use the analytical framework adopted in *Microsoft*.

As the *Microsoft* Court observed, market share may ***indicate*** market power, but market share does not ***prove*** market power. A firm may exercise market power while holding a relatively modest

[12] As this confusion over subscriber numbers indicates, the Commission must make significant efforts to improve its data collection and industry analysis if it intends to create an effective limit. *See* Part V, *infra.*

market share because of its role as a critical distributor, its control of particularly desirable customers, or some other reason based upon the structure of the industry. *See, e.g., Toys R Us v. FTC*, 221 F.3d 928 (D.C. Cir. 2000) . At the same time, a firm may enjoy large market share but prove unable to exercise market power because of the availability of competition. 253 F.3d at 51-52. *Accord TWE II*, 240 F.3d at 1134.

As a consequence, an examination of the effectiveness of competition must begin with the acid test set forth in *Microsoft*: the ability to rase rates above the competitive level. *Microsoft* at 51. If a firm can profitably raise rates above the competitive level, effective competition des not exist.

The evidence clearly demonstrates that DBS does not provide effective competition. As reported by the GAO, cable prices remain relatively unaffected by the availability of DBS as a competitor. By comparison, the presence of a terrestrial overbuilder provides true price competition, restraining cable prices by as much as 15%. GAO 2003 Competition. Furthermore, as discussed above, the availability of DBS does not indicate whether a cable MSO can offer poor customer service or refuse to carry desired programming, without fear of the consequences. National and regional concentration provide far better indicators of a cable operators ability to engage in the anticompetitive conduct Congress identified than the availability of DBS competition.

Well-accepted economic theory explains how this marketplace reality can occur, notwithstanding the rise in total DBS subscribers nationally. Competition relies consumers being able to move from one product to another or discontinue use of the product if prices or limitations become too onerous. Where consumers face difficulties switching, a dominant firm can exercise its market power secure in the knowledge that it will not lose customers to a rival. *Microsoft* at 51-54. This power increases in the face of inelastic demand and where available substitutes do not contain the same functionalities or are otherwise not "close" substitutes. *Id*. Finally, the consumer must have actual, rather than merely theoretical, access to the substitute. *Id*.

As discussed above, demand for MVPD programming is relatively inelastic and has no close substitutes other than programming from rival MVPDs. Subscribers migrating from an incumbent cable provider to DBS, however, face numerous barriers that minimize the effectiveness of DBS as a competitor.

Not everyone has physical access to DBS. Despite the "national availability" of DBS, many people in a wide variety of environments cannot physically subscribe to DBS. DBS requires an unobstructed view of the southern sky. In rural areas, significant forest coverage or mountains may block coverage. In suburban areas, trees may still pose a significant barrier. GAO 2005.

Most importantly, in urban areas that comprise the most profitable markets, three quarters of MDU units do not face south. If a landlord has an exclusive arrangement with an incumbent cable provider, three quarters of the building residents ***cannot*** switch to DBS no matter how dissatisfied they feel with the incumbent. Even those residents that face south, who may avail themselves of the Commission's Over the Air Receiver Device (OTARD) rules and buy a satellite antenna despite lease provisions to the contrary, tall buildings will block DBS signals and render DBS a non-option.[13] *Id.*

Switching costs lessen the effectiveness of DBS as a competitor. As the D.C. Circuit recognized in *Microsoft*, consumers balance dissatisfaction with a product against the costs of switching. These costs include a variety of factors from actual monetary costs associated with changing product or provider to less quantifiable costs such as time lost as a result of switching. *See*

[13]Even here, however, a non-physical barrier exists. Tenants must know they have a legal right to subscribe to DBS despite explicit lease provisions to the contrary, ***and*** must be willing to pursue their rights against possible landlord reprisals.

Andrew S. Wise and Kiran Duwadi, "Competition Between Cable Television and Direct Broadcast Satellite – It's More Complicated Than You Think," MB 2005-1 (2005) (discussing switching costs).

As Wise and Duwadi observed, consumers seeking to switch from an incumbent cable provider to a DBS provider face many switching costs. These include the cost of DBS equipment, time spent waiting for installation, time spent returning rented cable equipment, and time and effort spent learning the new system resetting preferences, and other hassle associated with the disruption of routine.[14] *Id.*

In addition to these costs, subscribers face other costs as well. First, to the extent DBS competitors cannot provide certain programming options – notably regional sports networks – the loss of such programming represents a cost to those wishing to switch. While access to local sports may not provide sufficient incentive to move a cable subscriber to switch to a competitor in the face of additional switching costs, the loss of such programming represents one more incremental cost preventing a consumer from changing MVPD. Wise and Duwadi at 21 (finding lower DBS penetration where cable networks carry local regional sports networks).

Finally, and most importantly for the future, subscribers that take both cable and broadband from an incumbent cable provider will face the loss of their email address and the additional hassle

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[14]With regard to Wise and Duwadi's attempts to determine a general price elasticity of cable versus DBS, Citizen Commenters suggest that Wise and Duwadi have made estimates overly generous to cable. In addition to the admitted problems in quantifying such variables as time lost waiting for installation or resistance to learning a new operating system, variables that will change with each subscriber, Wise and Duwadi make numerous simplifications for purposes of mathematical tractability that tend to distort the outcomes in favor of cross-elasticity. Most importantly, by focusing only on the basic cable expanded tier and ignoring the availability of broadband services, as well as the availability of digital channels used as an additional initial enticement to subscribe to cable whether or not the subscriber ultimately continues the digital tier past the free trial, Duwadi and Wise fail to include certain important switching costs discussed by Citizen Commenters.

of arranging for DSL or some other broadband provider. Loss of an email address, particularly with the increasing popularity of online bill paying and other online services, represents a very significant switching cost. As the Commission well knows from its proceedings on number portability, the need to switch phone numbers created a significant barrier to effective competition in telephony services requiring regulatory intervention. *Cf. Intermodal Number Portability*, 18 FCC 2d 23467 (2003). With the increased importance of an email address as an identifier and point of contact for everything from the mortgage to Harry Potter mailing lists, the need to change an email address represents a significant switching cost from cable to DBS.

In addition to the loss of email address itself, changing broadband providers essentially doubles the switching costs of migrating to DBS. Even where DBS providers resell DSL through a local provider, switching from cable to DSL requires learning a new system, installation of new software and equipment, and so on. Because cable MSOs have increasingly bundled their cable video and cable modem service, *see* Chris Stern, "Comcast Bundles Internet, TV to Keep Customers" (Washington Post, March 26, 2003), the average cable subscriber will not migrate to DBS for video programming while staying with cable for broadband access. *Cf. Microsoft* (that computers come with Microsoft OS pre-installed and paid for as part of purchase price barrier to alternative operating systems; need to maintain two operating systems to achieve full functionality desired by consumer barrier to entry).

DBS and cable provide a different suite of services. Increasingly, cable providers offer a "triple play" of video, voice, and data. DBS does not offer a comparable package, and the physical limitations of the technology effectively preclude it ever from being so. The need to rely upon multiple providers rather than one maximizes the switching costs and makes the products offered (DBS v. cable) less substitutable overall. The most recent GAO report noted this trend, finding the weakest

DBS subscriber growth in those franchise areas where cable systems had upgraded and offered advanced services. GAO 2005.

These factors do not, of course, act as a complete bar to migration from cable to DBS. But *TWE II* does not require such a finding to conclude that a 25% limit remains necessary to enhance effective competition. Rather, the Commission must "draw a connection between market power and the limit set." *TWE II*, 240 F.3d at 1134. In doing so, the Commission must "take account of the impact of DBS on that market power," and explain why, in the presence of an available competitor (like DBS), incumbent cable market power remains unchecked. *Id.*

The subsequent *en banc* decision of the D.C. Circuit in *Microsoft* provides the appropriate framework for making this inquiry. Using the *Microsoft* factors – availability of substitutes, switching costs, substitutability of goods – and cable operators' power "to raise prices profitably above the competitive level," the hallmark of a non-competitive market, demonstrate that DBS does not provide effective competition to cable incumbents.

2. The high rate of growth for DBS subscribership and increases in national DBS subscriber rates do not mandate a finding of effective competition.

Cable incumbents have set great store on improvements in the growth ***rate*** of subscribers and in the increase in the total number of national subscribers. Both the empirical evidence and the *Microsoft* factors make clear, however, that these two factors have not produced effective competition absent a 25% limit on national horizontal growth. As an initial matter, a high ***rate*** of growth means little if it builds upon a small base. For example, if DBS went from one subscriber in an entire market to two subscribers, it would have a growth rate of 100%. But this phenomenally high growth rate would not make DBS competitive with cable.

Similarly, as discussed below and in filings submitted by others, an examination of the market realities demonstrates that advertisers – and therefore programmers supported by advertisers – do not regard all subscribers as equal. Cable's capacity to keep and hold subscribers in the most profitable DMAs, and in the most profitable urban areas of DMAs, more than makes up for increases in the overall national subscriber numbers for DBS with regard to power over the programming market. Sports programming purchased directly from national sports leagues remains the only DBS-only programming, while numerous cable channels and regional sports networks rely exclusively on cable – and in particular on the one MSO to exceed the 25% limit CFA advocated in 2002. This disparity suggests that the National Football League and Major League Baseball are unique sellers, rather than that DBS provides effective competition.[15]

Finally, the evidence suggests that whatever competitive threat DBS providers offered the cable industry as a whole, Comcast's superior market power flowing from its national and regional concentration has negated this advantage. As late as October 2003, just prior to Comcast's acquisition of AT&T Broadband, the GAO observed that cable incumbents had improved their customer service in response to the threat of competition from DBS. 2003 GAO Competition. By 2005, numerous newspaper articles reported precipitous declines in Comcast customer service and frustration on the part of subscribers and local government officials. *See* Reply Comments of NATOA, *et al.*, Docket No. 05-192, and articles cited therein. Despite this decline in customer service – Comcast's one apparent response to DBS competition prior to passing the 25% national limit – Comcast has enjoyed

[15]By contrast, local teams appear more like conventional programmers in their reliance on and preference for cable carriage or terrestrial broadcast carriage. And, as Wise and Duwadi noted, the presence of a RSN on a cable system and the inability of a DBS competitor to provide the programming negatively impact te ability of DBS to attract customers from incumbent cable companies. Wise and Duwadi at 19.

record profits and increased subscriber growth, while DBS subscriber growth has tapered off. This suggests that a 25% limit remains necessary to “enhance effective competition” from providers such as DBS.

3. No other MVPD competitor currently provides effective national or regional competition.

Cable incumbents and the Commission frequently point to two other sources of potential competition: terrestrial overbuilders and entry by telephone companies. Certainly the presence of a terrestrial overbuilder acts to constrain price. GAO 2003 Competition. At the same time, however, overbuilders have complained repeatedly to the Commission and elsewhere that incumbent cable operators respond to competition from terrestrial overbuilders by exercising control over the local and national programming market to deny overbuilders necessary video programming. GAO, Wire-Based Competition Benefitted Consumers in Selected Markets (2004) (“GAO 2004"). The legislative history cites precisely this sort of program discrimination as a behavior the ownership limit must address. Senate Report at 14-16, 33.

To the extent other rules, such as the program access rules, could address the problem of discrimination based on regional and national dominance, the Commission has repeatedly foreclosed that approach by finding that cable operators may evade the rule by the simple expedient of delivering programming terrestrially (the “terrestrial loophole”).

As a consequence of the ability of incumbent cable operators to deny needed programming to overbuilders, overbuilders have failed to flourish as Congress had hoped. In addition, while some of the barriers to entry and switching costs associated with migration to DBS do not apply to overbuilders, such as the need to have a clear view of the southern sky, many of the other barriers and switching costs do apply. In particular where incumbents have exclusive arrangements with owners of MDUs for access to internal wiring, overbuilders lack the access rights DBS providers enjoy under the OTARD rules.

Accordingly, rather than demonstrating the presence of effective competition, the experience of terrestrial overbuilders demonstrates the need for a national and regional limit that curbs the ability of cable incumbents to engage in anticompetitive practices such as denial of needed local programming.

Finally, the incumbents and the Commission have made much of the possible entry of telephone companies into the provision of cable services. Congress foresaw the prospect of such competitive entry in 1992 and 1996, and sought to encourage such head to head competition.

While competition may ***ultimately*** emerge between cable and ILECs, such competition does not exist ***today***. A possible future competitor des not constrain the market power of an incumbent. *Microsoft* at 54 (possible emergence of other competitors too speculative). In particular, the possibility of a future competitor does not address the need to act prophylactically to ensure that the dominant provider will not block phone entry in the same fashion it has blocked competitive entry by overbuilders. *Accord Microsoft*. Given the repeated failure of ILECs to compete successfully with incumbent cable systems in the video services market, the potential entry of ILECs as competitors increases the urgency of setting a firm limit "in order to enhance effective competition."

B. Congress Considered Withholding of Programming, Demand for Equity Interest as a Condition of Carriage, and Denial of Carriage for Reasons Other Than Subscriber Preference "Unfair" – Practices That Continue Due to Lack of Effective Competition.

To review so far, Citizen Commenters have demonstrated in Part I that the effective competition that Congress intended to "enhance" has not emerged. In Part II, Citizen Commenters reiterated the underlying economic theory advanced four years ago by CFA, explaining, as required by the D.C. Circuit, the underlying economic rationale behind cable's anticompetitive practices vis a vis consumers and programmers. In response to the Commission's response in the *2nd FNPRM* that CFA had failed to provide sufficient empirical evidence, Citizen Commenters have supplied record evidence that Comcast, which has a national concentration above 25%, behaves in precisely the anticompetitive way predicted by CFA's model and contrary to models which either reject te need for a limit or propose a higher limit. This national concentration is further aggravated by the regional concentration effects discussed in Part III. Again, Comcast as the MSO with the greatest regional concentration has also displayed the greatest ability to exercise market power to the detriment of PEG programmers and local franchising authorities. In this way, Commentors address the demand of the *TWE II* Court to explain the link between concentration, market power, and how an effective limit will prevent operation of that market power.

In Part IV.A, Citizen Commenters addressed the D.C. Circuit's requirement that the Commission examine the ability of DBS (or other available rival MVPD) to act as an effective competitor to cable. That DBS does not provide effective competition however does not necessarily make the choices of cable operators "unfair." Citizen Commenters therefore address this criterion next.

In evaluating the Commission's "open field" approach, the *TWE II* Court, faulted the Commission for its failure to distinguish between "unfair" interference with the flow of programming and the legitimate editorial judgements of cable operators. In defining "unfair" within the meaning of Section 613(f)(2)(A), the Commission must effectuate the intent of Congress as understood using traditional tools of statutory construction. Again, the legislative history provides a clear set of criteria for what Congress considered "unfair" with regard to both consumers and programmers.

The drafters of the 1992 Act identified the following practices as "unfair" and flowing from cable market power at the local, regional and national level. As the Senate Committee explained:

> In addition to using its market power to the detriment of consumers directly, a cable operator may be able to use its market power to the detriment of programmers. Through greater control over programmers, a cable operator may be able to use its market power to the detriment of video distribution competitors.

Senate Report at 23. The Committee observed that cable operators leveraged their control of subscribers to demand equity interests in programming. Cable operators further leveraged their control to favor affiliated networks over unaffiliated networks. The Committee observed that cable operators also denied affiliated programming to rivals or required unaffiliated programmers to forgo distribution on rival MVPD platforms. In addition to outright denial of programming, cable operators also engaged in discriminatory pricing, charging potential rivals. *Id*. At 29. The Committee also expressed concern that concentration would permit cable operators to engage in other "anticompetitive acts." *Id.* at 33.

Similarly, the House Committee Report observed that "horizontal concentration provides incentives for MSOs to impede competition by discouraging the formation of new cable programming services." House Report at 42. Like the Senate, it noted with particular concern the ability to favor affiliated programming, prevent the formation of rival unaffiliated programming, and the ability to exact concessions such as equity and exclusivity from programmers. *Id.* 42-43. Finally, it is useful to note that the Senate debate included insertion of a Washington Post article about the power of TCI – which controlled 25% of the national market -- over the programming market. 138 Cong. Rec. S. 417-18 (January 27, 1992).

The Committee expressed the concern that while any given act could have a legitimate purpose, the absence of effective competition would transform these same acts into barriers to entry. Senate Report at 28. As the D.C. Circuit has said, a practice or feature permissible in competitive markets may warrant government action if it creates barriers to entry that protect the market power of a dominant firm. *Microsoft* at 56 (although Microsoft may have gained dominance through competition and product superiority, "because the applications barrier to entry protects a dominant operating system irrespective of quality, it gives Microsoft power to stave off even superior new rivals").

From this legislative history, the Commission can determine Congress' meaning of "unfair." The legislative history indicates that a cable operator behaves "unfairly" when it (a) has market power, and (b) uses that power to require equity or exclusivity as a price of carriage, favors affiliated programming over unaffiliated programming, withholds programming from rivals, or otherwise demonstrates market power over programers.

This does not require the Commission to sit in judgement over the individual programming decisions of cable operators. To the contrary, except for the specific instances in which Congress created a right of action and a complaint process, Congress sought to avoid direct regulation of individual business decisions by imposing a horizontal limit that would prevent the exercise of market power and enhance competition. As the Senate Report observed, in the absence of market power, cable operators' business decisions on programming would not distort the MVPD market. Senate Report at 28. It therefore directed the Commission to promote "fair" competition and address "unfair" interference with the programming market by creating horizontal and vertical limits set low enough to eliminate market power. This will "enhance effective competition" (the overall purpose of Section 613(f)) by eliminating the ability of cable operators to act unfairly, *i.e.*, use their market power to the detriment of programmers and, by extension, MVPD competitors.

Use of the monopsony framework to define "fair" and "unfair" has a further advantage. The *TWE II* Court expressed concern that the "open field" approach would require intrusive regulation into the editorial choices of cable operators, raising First Amendment concerns. *TWE II* at 1130-31. The horizontal limit, however, acts against monopsony power rather than on programming discretion. Limits on market power do not violate the First Amendment; to the contrary, limits on market power serve the purposes of the First Amendment by promoting the creation of multiple diverse and genuinely antagonistic sources of news and information on which democracy depends. *Associated Press v. United States*, 326 U.S. 1, 20 (1945).

To conclude, the Commission must define the appropriate national and regional limit to enhance effective competition and limit the exercise of market power. Limits on market power will "ensure" that cable operators cannot interfere "unfairly" in the flow of programming between programmer and viewer or "unreasonably" restrict access to programming by rival MVPDs. Section 613(f)(2)(A)-(B). By contrast, where market power exists, a pattern of favoring affiliated networks, demanding equity, discriminating against rival MVPDs, and other practices described by the Senate and House Reports demonstrates "unfair" interference in the flow of programming.

C. The Last Three Years Have Provided More Than Sufficient Proof of "Real" Rather Than "Conjectural" Harms.

Finally, Commentors address the issue of "real" rather than "conjectural" harm. The Commission, in its previous order, failed to address the state of effective competition with reference to the criteria identified in the statute or the legislative history. Instead, the Commission's 1999 Order, utilizing the "open field" approach, sought to ensure a theoretical opportunity for any given programmer. Unsurprisingly, the D.C. Circuit expressed skepticism with this approach and required the Commission to demonstrate a likelihood of real harm with regard to any specific decision by MSOs.

A proper understanding of the nature of the Section 613(f) and the purpose of this section in the role of the enhancing effective competition resolves the confusion over both the nature of the harm and its reality. It requires no great powers of prediction or agency expertise to observe that the harms Congress identified as arising out of the lack of effective competition have grown increasingly severe as concentration has increased.

In previous sections, Commentors observed that prices have risen in an unconstrained fashion consistent with the exercise of monopsony power, customer service – particularly that provided to Comcast customers – has fallen precipitously, and local governments find themselves increasingly unable to force Comcast to comply with previously agreed upon franchising terms. As a consequence of Comcast's increased power against LFAs since surpassing 25% national concentration, Comcast has consistently – and unfairly – interfered with the flow of PEG programming from PEG programers to viewers.

With regard to the commercial programing market, the problems of concentration persist as well. Numerous studies and complaints to the Commission have demonstrated that an unaffiliated network has little chance of carriage, while networks affiliated with cable operators or broadcast networks will receive carriage. *See, e.g.,* Michael E. Clements and Amy Abramowitz, "Ownership Affiliation and the Programming Decisions of Cable Operators," U.S. Government Accountability Office (2004). Furthermore, since Comcast reached its current size, virtually no network has succeeded without carriage by Comcast. *Petition to Deny of The America Channel,* MB Docket No. 05-192 (filed July 21, 2005).

Perhaps most telling are the comments of cable's wealthiest programmers and entrepreneurs. In response to the question of how it felt to negotiate with Comcast as an unaffiliated programmer, cable Billionaire and pioneer John Malone replied "They kicked the shit out of us!" Mark Robichaux, "From Darth Vader to Yoda," Broadcasting and Cable April 4, 2005.

When running TCI, Malone gained a reputation as the "Darth Vader" of cable – able to kill networks with a gesture or guarantee their success by promising support. Apparently, as the interview makes clear, this power came primarily from the ability to leverage TCI's market power rather than simply from Malone's negotiating skills:

> B&C: But you're Darth Vader.
>
> Malone: I used to be. I used to have the market power to be Darth Vader. I don't anymore.
>
> B&C: Do you miss being Darth Vader?
>
> Malone: I miss the market power, absolutely. When you've got market power, it's a lot easier to be right. When you don't have market power, it's much harder. So sure. But I also think Brian Roberts' politics are much better than mine ever were. On the other hand, I think he's being probably more brutal to his vendors than I ever was.

It seems unlikely that Congress considered "fair" competition to flow from a combination of market power and the right "politics," particularly Congress' concern that cable operators of sufficient size might "slant information according to their own biases." Senate Report at 32. For possible censorship based on Brian Roberts' "better" politics, *see*, *e.g.*, Alicia Mundy, "Rejected Antiwar Ad Stirs Consolidation Opponents," Cable World (February 2003).

If Comcast, at almost 30% of the market, has the power to "kick the shit" out of such large unaffiliated programmers as Liberty Media (which holds "marquis" programming such as Discovery

Network and Starz!), what power does it exercise over fledgling independents? In the assessment of Dr. Malone, absolute power.

> Malone: Basically, the consolidation of the business has got to the point where I don't believe that an independent programmer has any chance whatsoever of doing anything unless he's heavily invested in and supported by one of the major distributors.
>
> B&C: But you were in this very catbird seat just eight years ago. This now sounds like a different tune.
>
> Malone: TCI was never big enough that we could stop anything. We were big enough that we could never kill anybody. ***But there's no way on Earth that you can be successful in the U.S. distributing a channel that Brian Roberts doesn't carry, particularly if he has one that competes with it.***

"From Darth Vader to Yoda" *supra.*

To put this in the language of the statute, Comcast has grown large enough that it can "unfairly impede...the flow of video programming from video programmer to the consumer" favor affiliated programming over unaffiliated programming. Section 613(f)(2)(A)-(B). This assessment is shared by other previously successful programmers. Recently, Ted Turner told an audience that they would be better off trying to break into the restaurant business rather than the cable programming business, as independents can freely enter the restaurant business but not the programming business. Ed Martin, "Ted Turner at NATPE: Bullish on Bison Burgers, Fed Up With Media Mergers, Jack Myers Entertainment Report (January 26, 2005).[16] Barry Diller, another former independent programmer, told Bill Moyers that it was "almost impossible" for a "young Barry Diller" or a "young Ted Turner" to start an independent network today because "if you knock on the doors of these entities [cable systems], they say 'well, first of all, you know, it's not independent by definition because we'll own

[16]Available at http://www.mediavillage.com/jmentr/2005/01/26/jmer-01-26-05/.

it.' You know? There's no chance you can own it. That's gone now."[17]

This has nothing to do with what the D.C. Circuit described as the independent editorial decisions of cable operators about specific channels. Rather, as Congress recognized, the pattern of behavior flows from the market power of a cable operator with concentration above the necessary threshold. The decisions are "unfair" because, absent effective competition, the pattern persists and creates anticompetitive results that reenforce the dominant operators monopsony power over program providers and prevents "unorthodox or unpopular speech" and speech that disagrees with the "politics" of the dominant cable operator from reaching the public. Senate Report at 32-34. Or, as explained by the D.C. Circuit, however cable operators achieved dominance, the fact remains that the ability to pick and chose what networks will succeed creates an entry barrier the government may address to create effective competition. *Microsoft* at 56.

Given the evidence of the ongoing harm, and the continuation of market power, the rule is no longer prophylactic. In the three years since Comcast crossed the 25% threshold urged by CFA, it has gained sufficient market power to engage in precisely the behavior Congress ordered the FCC to prevent through a horizontal ownership limit. Until the FCC takes action to create a horizontal limit that constrains the power of cable's dominant players, these real (rather than conjectural) harms will continue.

V. THE COMMISSION MUST ADDRESS SERIOUS DEFICIENCIES IN ITS INFORMATION COLLECTION IF IT HOPES TO CREATE REAL SOLUTIONS TO THE PROBLEMS CONGRESS IDENTIFIED.

The Commission's efforts to enhance effective competition in the industry have sadly suffered from the Commission's reliance on the cable industry for hard information. To the extent the industry

[17] Available at http://www.pbs.org/now/transcript/transcript_diller.html.

receives information from non-cable sources, those sources suffer from the fact that the cable industry holds all the relevant information as proprietary. Industry reporters, such as Nielsen, also rely on the cable industry and the satellite industry for subscriber information. The FCC makes no effort to investigate cable information independently, to conduct its own random survey, or to verify that the information it receives from interested parties is accurate. The Commission does not even avail itself of such public information as corporate SEC filings, relying on interested parties with limited resources to bring relevant statements to its attention.

The FCC's collection of cable industry data is so poor and so easy for interested parties to manipulate that the GAO devoted an entire report to explain why FCC reports on cost structures and competition in the MVPD industry diverged so radically from the conditions the GAO found when it conducted its own study of the MVPD market. GAO, "Data Gathering Weaknesses in FCC's Survey of Information on Factors Underlying Cable Rate Changes," (2003). In a subsequent report, the GAO criticized the FCC for its continued failure to collect necessary data on the cable industry, its practices, and the provision of new services. GAO 2003 Competition at 19. The GAO faulted the FCC for its failure to independently validate numbers provided by the private sector, particularly when regulated entities with an interested in manipulating the outcomes were themselves the sources of the information. *Id.*

As the GAO observed, the consequence of the FCC's poor data collection and subsequent unreliable reporting have profound consequences:

> FCC's findings provide the Congress with information relevant to important policy decisions including regulation of cable rates and/or services and media consolidation and convergence of video, voice and data services. ***The lack of reliable information in the FCC's cable rate report may compromise the ability of Congress to make these important policy decisions and of the FCC to monitor and provide oversight***

of the cable industry.

GAO 2003 Competition at 19.

Sadly, in the last two years, the FCC has made no effort to improve its data collection. Worse, as non-cable parties have seen the futility of educating the Commission that effective competition does not in fact exist, the level of participation in the FCC's data collection proceedings has declined. As a consequence, the Commission's reliance on its traditional practices has made its information increasingly inaccurate.

Private companies, familiar with the FCC's collection and processing weaknesses, have learned to "game the system" to create an illusion of competition. Sadly, the FCC actively encourages and facilitates this conduct by manipulating the way in which it presents data. For example, the FCC continues to alter the questions asked and statistics presented in its annual competition report, making it impossible to compare significant variables over time and creating a false impression of ever increasing competition.

For example, the FCC measures regional "penetration" by availability within a zip code of a potential competitor. It makes no effort to determine actual penetration by region or to what extent the competitor, by virtue of natural or artificial barriers is genuinely physically available. By assuming 100% availability of DBS signal within the 48 contiguous states the Commission can declare each market "penetrated" by two DBS providers and an incumbent cable operator. As the Commission well knows, however, a large number of urban dwellers and some rural dwellers cannot physically receive a DBS signal, GAO 2005. The FCC continues to tout the national growth rate of DBS subscribers as proof of competition with the largest incumbent cable operators without any attempt to measure whether new DBS subscribers represent gains from competitive cable systems or provide genuine competition as measured by impacts on pricing and quality of service. *Cf.* GAO 2005 (examining pattern DBS adoption).

Given the increasing evidence that increased national and regional concentration has enhanced cable market power to the detriment of consumers, video programmers, and rival MVPDs, the Commission must significantly improve its data collection processes.

First, the Commission must require accurate and certified subscriber counts from MVPDs, broken down by LFA, with the actual availability of the service to the population of the LFA clearly indicated. The Commission must cease relying on unverified subscriber data provided by private vendors – a practice the GAO explicitly criticized as subject to manipulation by interested industry participants. It should also cease the practice of assuming that availability of a service within a zip code means that the service is universally available within that zip code. At the very least, as CFA and others have petitioned the Commission, the Commission must stop allowing cable incumbents to submit "any generally acceptable industry data" to demonstrate compliance with ownership limits. The ability to "shop" for the most favorable number renders the Commission's data collection process highly suspect.

Second, the Commission must actively collect industry contracts on programming negotiations to discern if patterns of abuse exist. As this data is proprietary, the Commission should not initially make it part of the public record, except in the form of aggregate information and conclusions regarding industry trends. If a broad pattern of abuses continues, however, the Commission should consider whether to require some form of public disclosure.

Third, the Commission must punish incumbents that take retaliatory action against programmers for providing information to the Commission. It is no surprise that, when the Commission conducted a voluntary survey of programmers in 2003, ***not a single programmer responded.*** Given the risks involved, and the unlikelihood of Commission action to address issues brought to its attention, what rational programmer would respond?

Worse, the Commission has gone out of its way to avoid knowing the terms of agreements which would indicate an abuse of market power. In 2003, for example, the Commission strenuously resisted considering an agreement between Comcast and Time Warner on broadband access – despite widespread press reports that the terms of the agreement indicated Comcast's post-merger market power over the broadband market.

Finally, the Commission has a responsibility to conduct a genuine and extensive inquiry into whether the "70/70" conditions of Section 612(g) have been met. The Commission's treatment of Section 612(g) in the *11th Annual MVPD Competition Report* is particularly troubling, and raises grave concerns as to the Commission's willingness to discharge its responsibility to protect the public. In the *11th Annual Report*, the Commission relied upon a private company to determine that (a) more than 70% of households were passed by cable systems with 36 or more activated channels, but (b) only 68.9% of homes subscribe to these systems. *11th Annual Report*, 20 FCCRcd at 2766-68.

Given a result so close to the statutory threshold, the Commission should have implemented the recommendations of the GAO and independently verified the data by compelling certified subscriber numbers from cable operators. Instead, the Commission verified the data by "sampling" the cable rate survey data the GAO had twice criticized as unreliable. Without disclosing its methodology, the Commission concluded that the number of subscribers was "really" only 58.8%. The Commission further stated that verification of the 70/70 threshold against the raw data collected on Form 325 dropped subscribership of cable systems with 36 activated channels or more to 54.7%.

The Commission did not explain what created a discrepancy of 4.1% between the raw data on which it based the Rate Report and the actual Rate Report itself.

More troubling still, the Commission relied on ***projected*** loses from incumbents. The Commission took no steps to verify these numbers from the public SEC filings of the largest incumbents. The Commission noted that the National Cable Television Association, the trade organization to which all major cable incumbents belonged, reported an ***increase*** in overall cable subscribers rather than a decrease, but dismissed this contradictory evidence without explanation. *Id.* n.47. To the extent the projected loses actually happened, the Commission did not investigate what percentage of these former incumbent customers migrated to terrestrial overbuilders rather than DBS providers. As subscribers to terrestrial overbuilders remain cable subscribers, incumbent loses to terrestrial overbuilders would still count toward the 70/70 threshold.[18]

Although the *TWE II* Court found that under Section 613(f) the Commission could not set an ownership limits solely on the grounds that the limit would increase diversity of voices on cable, Section 612(g) orders the Commission to take whatever steps necessary to promote diversity in cable programming. Because our democracy depends on fostering a multitude of diverse and genuinely antagonistic sources of news and information, the Commission should take particular care in evaluating whether the market has met the 70/70 threshold. This need becomes particularly acute in light of evidence that Comcast has not hesitated to use its national and regional concentration to censor advertising based on political content. *See, e.g.* Sanford Nowlin, "SBC Says Cable Company Silencing It," San Antonio Express News (April 27, 2005) (refusal to run advertisement in support of legislation

[18]To what extent fiber deployments by telephone companies "count" toward the 70/70 limit has not been addressed by the Commission. The Commission need not resolve this question here.

Comcast actively opposed); Russ Baker, "Strangling Public Debate," Tompaine.com (February 14, 2004) (refusal to run advertisements in support of changing the marijuana laws).

CONCLUSION

The Commission should adopt a monopsony framework rather than the creation of a sufficient "open field" for programmer survival in a hypothetically competitive market. The availability of possible viewers does nothing to resolve the problems Congress intended the Commission to address with a horizontal ownership limit. This includes sufficient limits on regional concentration to negate the exercise of market power, protect the flow of PEG programming, and otherwise serve the public interest. Furthermore, if the Commission intends to set an effective limit based on a true understanding of industry structure, it must reform its data collection and data processing practices by requiring industry participants to provide certified subscriber numbers and copies of bargaining agreements between MSOs and programmers for its review.

Respectfully submitted,

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ATTACHMENT A

CABLE INDUSTRY REVENUE GROWTH STATISTICS: 1985 - 2004

Year	Basic Cable Customers	Basic Revenue	Premium Revenue	Other Revenue	Total Revenue
2004	73,575,460	$30,336,000,000	$5,871,000,000	$21,393,000,000	$57,600,000,000
	per sub per month:	*$34.36*	*$6.65*	*$24.23*	*$65.24*
2003	73,365,880	$28,960,000,000	$5,190,000,000	$17,150,000,000	$51,300,000,000
	per sub per month:	*$32.89*	*$5.90*	*$19.48*	*$58.27*
2002	73,525,150	$28,492,000,000	$5,533,000,000	$15,402,000,000	$49,427,000,000
	per sub per month:	*$32.29*	*$6.27*	*$17.46*	*$56.02*
2001	72,958,180	$27,031,000,000	$5,259,000,000	$11,228,000,000	$43,518,000,000
	per sub per month:	*$30.87*	*$6.01*	*$12.82*	*$49.71*
2000	69,297,290	$24,445,000,000	$4,949,000,000	$11,461,000,000	$40,855,000,000
	per sub per month:	*$29.40*	*$5.95*	*$13.78*	*$49.13*
1999	68,537,980	$23,146,000,000	$4,930,000,000	$8,843,000,000	$36,919,000,000
	per sub per month:	*$28.14*	*$5.99*	*$10.75*	*$44.89*
1998	67,011,180	$21,830,000,000	$4,857,000,000	$6,816,000,000	$33,503,000,000
	per sub per month:	*$27.15*	*$6.04*	*$8.48*	*$41.66*
1997	65,929,420	$20,405,000,000	$4,823,000,000	$5,265,000,000	$30,493,000,000
	per sub per month:	*$25.79*	*$6.10*	*$6.65*	*$38.54*
1996	64,654,160	$18,395,000,000	$4,757,000,000	$4,554,000,000	$27,706,000,000
	per sub per month:	*$23.71*	*$6.13*	*$5.87*	*$35.71*
1995	62,956,470	$16,860,000,000	$4,607,000,000	$3,954,000,000	$25,421,000,000
	per sub per month:	*$22.32*	*$6.10*	*$5.23*	*$33.65*
1994	60,495,090	$15,170,000,000	$4,394,000,000	$3,570,000,000	$23,134,000,000
	per sub per month:	*$20.90*	*$6.05*	*$4.92*	*$31.87*
1993	58,834,440	$13,528,000,000	$4,810,000,000	$4,505,000,000	$22,843,000,000
	per sub per month:	*$19.16*	*$6.81*	*$6.38*	*$32.35*
1992	57,211,600	$12,433,000,000	$5,108,000,000	$3,538,000,000	$21,079,000,000
	per sub per month:	*$18.11*	*$7.44*	*$5.15*	*$30.70*
1991	55,786,390	$11,418,000,000	$4,968,000,000	$3,040,000,000	$19,426,000,000
	per sub per month:	*$17.06*	*$7.42*	*$4.54*	*$29.02*
1990	54,871,330	$10,174,000,000	$4,882,000,000	$2,526,000,000	$17,582,000,000
	per sub per month:	*$15.45*	*$7.41*	*$3.84*	*$26.70*
1989	52,564,470	$8,671,000,000	$4,663,000,000	$2,044,000,000	$15,378,000,000
	per sub per month:	*$13.75*	*$7.39*	*$3.24*	*$24.38*
1988	48,636,520	$7,345,000,000	$4,308,000,000	$1,756,000,000	$13,409,000,000
	per sub per month:	*$12.58*	*$7.38*	*$3.01*	*$22.97*
1987	44,970,880	$6,016,000,000	$3,959,000,000	$1,588,000,000	$11,563,000,000
	per sub per month:	*$11.15*	*$7.34*	*$2.94*	*$21.43*
1986	42,237,140	$4,887,000,000	$3,767,000,000	$1,301,000,000	$9,955,000,000
	per sub per month:	*$9.64*	*$7.43*	*$2.57*	*$19.64*
1985	39,872,520	$4,138,000,000	$3,610,000,000	$583,000,000	$8,331,000,000
	per sub per month:	*$8.65*	*$7.54*	*$1.22*	*$17.41*

"Premium Revenue" combines revenue from stand-alone (or multiplex) movie channels.
"Other Revenue" includes advertising revenue, digital tier revenue,
home shopping commissions, cable modem and telephony revenues, etc.
Source: NCTA web site (12-22-04)